

Taxation, Internal Security, and the Transformation of the State

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1. European Integration and the State: Substitute, Rescue, Constraint or What?

The early days of European integration were dominated by federalist visions of the Euro-polity. It seemed clear that the EU would sooner or later replace the nation-state as the centre of political authority (Haas 1964; Pinder/Pryce 1969). Even important national political actors strived for the United States of Europe which would have reduced the EU's member states to subunits in a large federal state (Jachtenfuchs 2002: 171-82). The dominant academic paradigm, neo-functionalism, reflected and rationalized the wide spread expectation of the coming of a federal Europe.

When this expectation was shattered first by the failure of the EDC in the 1950s and by the crisis of the empty chair in the 1960s, and finally collapsed with British entry in the 1970s, scientific accounts of European integration became more sober and sceptical. Fears or hopes of the EU replacing the

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member states as central units of political organization and identification seemed misplaced and grossly overdrawn.

Liberal intergovernmentalism argued that member states had the integration process under firm control. They created European institutions as a means to solving collective action problems and mitigate policy externalities, but kept these institutions under close supervision and did not transfer any central elements of domestic rule and national sovereignty (defense, police, taxation, large-scale redistribution) to them (Moravcsik 2002: 607). Basic institutional and policy issues are decided at key intergovernmental conferences, where even 'good Europeans' such as the German government are motivated by the wish to further sectoral domestic interests rather than a federalist ideology (Moravcsik 1998). Also historical accounts seemed to confirm that despite all federalist rhetoric, the thrust behind integration was to rescue the nation state by European means and not to undermine it (Milward 1992).

The recent wave of research on Europeanization is, at least in part, a reaction to the liberal intergovernmentalist claim that states shape the EU and not vice versa (Risse/Green Cowles/Caporaso 2001: 14-5). To challenge this claim, it focuses not on how domestic interests, policies and structures affect the Euro-Polity but on how they are in turn affected by it (Featherstone/Radaelli 2003). The research on Europeanization has produced substantial evidence that European stimuli do indeed change domestic interests, policies and structures, thus painting a mirror image to intergovernmentalism's portrayal of European integration. Still it shares one fundamental assumption with its rival, namely that the state remains basically intact as a self-contained system of government. While in intergovernmentalism, the state appears as a self-contained system of preference aggregation, it is conceived as a self-contained system of rule implementation in Europeanization research.

The assumption of the self-contained state has been criticized from a multi-level governance perspective. Proponents of this perspective claim that integration neither simply empowers the state (as in the liberal intergovernmentalist account) nor just constrains it (as in the Europeanization debate) but transforms the state in a fundamental way. The state is broken up as a self-contained system of rule and embedded in a larger, overarching European system of government. Rather than constituting distinct and separate spheres, the national and the European level are integral parts of a multi-level structure in which neither of them is bound to disappear or to

dominate the other (Hooghe/Marks 2001, 2003; Jachtenfuchs/Kohler-Koch 2004).

Given multiple political and institutional links between member states and EU institution, the multi-level approach makes intuitive phenomenological sense. However, it also raises tough questions. One set of questions refers to the *Gestalt* of the EU-polity. If it is true, that the EU constitutes an integrated multi-level system rather than an assemblage of intergovernmentally coordinated national systems, how then does it differ from a federal polity? How can we conceive of the EU as being multi-level (in some interesting sense of the word) without at the same time being federal? And if multi-level Europe is not federal how can it be powerful enough to break up such a formidable institution as the West European nation state? A second set of questions refers to the nation state. If it is indeed true, as the multi-level perspective suggests, that the member states of the EU are absorbed into an overarching European system of rule, why is it that they are still perceived as the pre-eminent actors in the European polity? If the level of political integration is really the European and not the national, why then is it not also the focus of political agitation, identification, and loyalty as the old neo-functionalists predicted?

The purpose of this paper is to answer these questions. We want to demonstrate that the EU is indeed a multi-level system although it is not federation and unlikely to turn federal any time soon. And we want to explain why the state remains the central unit of political organization in the EU despite being absorbed into this multi-level system. For this purpose, we focus on two constitutive powers of the state, the power to tax and the power to legitimately use force (Tilly 1990; Schumpeter [1918] 1991); (Weber [1922] 1978), and analyse how they are reconfigured in the process of European integration.

The structure of the paper is as follows. In the next section (section 2) we give a stylized account of the historical evolution of the power to tax and use force in processes of European state formation. By the mid-20th century, states had secured an undisputed legal monopoly of force and taxation and virtually exclusive decision making authority over these instruments. As we demonstrate in the following sections, the process of European integration leads to a fundamental, if rarely acknowledged, reconfiguration of these powers. This reconfiguration is characterized by two contradictory trends. On the one hand, the legal monopoly of force and taxation remains exclusively national. There is neither a European police force nor a European tax

– and it is highly unlikely that there will be any in the near future. The right to impose taxes and mandate the use of force remains an exclusive national prerogative (section 3). On the other hand, the EU increasingly usurps decision-making authority over internal security and taxation: EU institutions decide instead of national governments on issues of tax and internal security policy or, at least, pre-structure national decisions. As we will show, these decisions are not restricted to secondary issues but affect the core of national tax and internal security policy, and they are no longer under tight member state control (section 4).

The concluding section (section 5) sketches the emerging new order of European taxation and internal security. It is decidedly non-federal because the European level lacks the power to tax and mandate the use of force – no European taxes or police forces. However, it is multi-level because national tax and internal security policies are increasingly guided, controlled and constrained by European level decisions. The state remains central because the legal monopoly of force and taxation remains national. However, it is broken up as a self-contained unit of decision making on taxation and internal security. These are increasingly co-decided or even pre-empted by European institutions.

2. The National Monopoly of Force and Taxation

In this section, we argue that the key feature distinguishing the state from other forms of political organization is the monopoly of force and taxation. Processes of state formation in Europe evolved around attempts to assert and consolidate this monopoly. By the 20th century this process was complete. States enjoyed an undisputed legal claim to the exclusive use of force and taxation within their national territories, *and* possessed the means to enforce this claim effectively.

The modern state was built on money and violence. It emerged in early modern Europe as an institutional device for mobilizing force and organizing extraction. Well into the 19th century its two overriding, and mutually reinforcing, concerns were to collect taxes and to raise and deploy armies and navies. Since then, the range of state activities has greatly expanded. Over the 20th century, the state has come to deal with policy issues as diverse as social security, gender equality, environmental protection or the organization of major sporting events. Still the feature that most clearly sets it apart from other political institutions is its monopoly of force and taxation:

The state, and only the state, can mandate the use of force and levy taxes within the national territory. No other entity is entitled to do so (see e.g. Poggi 1990; Tilly 1990; Zürn and Leibfried 2005).

The monopoly of force and taxation is a matter of law not of fact, of authority not of sheer muscle. It represents a legal claim but not necessarily a political reality. As the example of so-called 'failed states' clearly demonstrates, states are not always able to effectively enforce this claim. And even in Western Europe, where the effectiveness of the monopoly of force and taxation is usually taken for granted, this has not always been the case. In fact, most of the state's history since the 15th century was spent on asserting the monopoly and backing it up with effective control. In the course of a long and laborious process, the state challenged the right of non-state actors such as the Roman emperor, the church, the cities or the nobility to levy their own taxes and make self-mandated use of force, excluded them from tax or security related decision making, and entrusted the implementation of tax and security laws to state agencies. Private tax farmers were replaced by public tax administrators, mercenary armies made way to regular armed forces, national police penetrated local communities and local police operations were submitted to state control (Tilly 1990; Reinhard 1999).

The assertion and consolidation of the state's power to tax and use force started at different times and proceeded at different speeds in different parts of Europe. However, it led to similar outcomes everywhere. By the mid-20th century, taxation and the provision of internal security were characterized by two prevailing features in all West European States. First, the state's *monopoly* of force and taxation was uncontested. It was broadly accepted that the state was the only political unit entitled to mandate the use of force or levy compulsory payments within its territory. No plausible challenger to this monopoly was in sight. The downside to this was that the state also had to assume full responsibility for all real or perceived failures of tax or internal security policy. Any deficiency or injustice was invariably attributed to the state, and to the state and its representatives alone. Second, the state enjoyed near-complete *decision making control* over taxation and internal security. In other words, taxes were not only levied, and force applied in the name of the state, but also on the basis of state decisions of state organs. The state through its government and administration decided what taxes to levy and under what conditions to use force. No other political organization interfered with state decisions in these fields.

The combination of legal monopoly and effective decision-making control made European states sovereign in taxation and internal security. They used this sovereignty to develop distinctly national systems of taxation and internal security. The cross-national variance of policy regimes is well recorded and does not need to be demonstrated here (for taxation just see Peters 1986; for internal security see Bayley 1985). It is important to stress, however, that this variance was rooted in one basic similarity, namely the states' exclusive legal claim to and effective control of taxation and force control within the national territory.

3. No European Monopoly of Force and Taxation

The process of European Integration leads to a fundamental reconfiguration of taxing and policing powers in the EU. While it leaves the member states' *legal* monopoly of force and taxation intact, and may in fact reinforce it, it undermines their *effective* control over decision making. Taxes and police forces remain national but the conditions of their use are increasingly defined and controlled by European institutions. The state as a self-contained unit of policing and taxation is broken up and embedded in an increasingly dense network of European rules and regulations. In this section we explain why the EU has no independent tax and police powers and is unlikely to get them any time soon. In the following section (section 4) we analyse why this has not prevented European institutions from increasingly usurping decision making authority over taxation and police matters.

Unlike its member states, the EU has neither the legal right nor the administrative means to apply force or impose taxes. There is no such thing as a genuine European army, police force or tax, and, by implication, there is also no such thing as a European state (Jachtenfuchs 2006). In the early days of European integration, when hopes for a United States of Europe were still rising high, the introduction of European level taxes or armed forces appeared as a real prospect. However, as the appeal of the federal vision faded with consecutive rounds of enlargement, this prospect became increasingly unreal and utopian. As the EU grew larger and more heterogeneous, its cohesion came to depend crucially on its visibly not being a state and on the member states visibly remaining states. While there is no consensus as to what the EU's *finalité politique* is, there is wide spread consensus that it cannot and should possibly be a European federal state. This precludes the transfer of Europeanization of the most important insignia of statehood:

taxation and force. They have to remain national for the sake of European unity.

3.1 Taxation

While the introduction of a genuine European tax is a perennial theme in European politics (Neumark Report 1963; Strauss-Kahn 2004), the EU is no closer to having a tax of its own today than the ECSC was back in the 1950s. In fact, it may be farther away. The importance of tax-like supranational levies for funding the Community budget has decreased, and the importance of national contributions increased over time. There is a pervasive trend towards intergovernmentalism in Community finances. The EU's so-called own resource system has come to closely resemble the funding schemes of international institutions such as the IMF. It is worlds apart from the tax systems of federal, let alone unitary nation states.

When the six founding members established the European Coal and Steel Community (ECSC) in 1951, they based the funding on a system of supranational levies on coal and steel production. The levies were to be charged directly by the ECSC on individual economic agents – companies – and thus bore a close resemblance to supranational taxes. The EEC-treaty of 1957 returned to a classic, intergovernmental funding scheme based on national contributions by the member states but made provisions for an eventual switch to a new, and supposedly more supranational system of Community 'own resources' (Article 201, now 269). The first own resources assigned to the Community in 1971 were customs duties and agricultural levies. Like the ECSC levies, these so-called traditional own resources are charged directly on economic agents – importers and agricultural producers – and thus create a direct, tax-like fiscal link between the Community and individual or corporate citizens. However, the agents paying these duties were few in number, and did not represent the citizenship at large. Also, they generated insufficient resources for funding the Community budget. The so-called VAT own resource introduced in 1979, was supposed to alleviate both problems.

Initially, the VAT resource was envisaged as a European surcharge on top of national VATs. Thus, it would allow the Community to not only tap into a buoyant source of revenue but also raise its public profile as a revenue raiser in its own right. But the surcharge system required a complete harmonization of the VAT basis across the member states. However, while the

Council agreed on a substantial approximation of the VAT base in 1977, a complete harmonization proved elusive. The surcharge approach was given up and replaced by a statistical approach of calculating VAT resource dues from data on macroeconomic consumption. This was administratively convenient and reduced the pressure for further VAT harmonization. But it fundamentally changed the character of the VAT resource from direct European charge on final consumers to national contribution by member states. Despite its name, there is no straightforward connection between the European VAT resource and national VATs. Rather it is a transfer from national treasuries to the EU paid out of general revenues (Genschel 2002: 80-90).

The trend from direct charges to national contributions was further reinforced by the introduction of the so-called GNI-based own resource in 1988. In contrast to the VAT resource, it was conceived right from the beginning as a transfer from national treasuries rather than a direct charge on European citizens. It is calculated as a fixed share of the gross national income of the member states without even notional reference to microeconomic events or actors. While initially planned as a residual source of finance, it has developed into the main stay of the Community budget. In 2005 it accounted for roughly 3/4 of all own resources. Add to this the VAT resource and almost 90 percent of Community own resources derive from national contributions (European Commission 2004: technical annex p. 8).

In conclusion, there is a pervasive trend in Community finance away from direct charges on individual or corporate citizens towards national contributions by the member states, i.e. from supranational to intergovernmental sources of revenue. This trend is reflected by pervasive concerns about inter-nation equity, which have dominated political debates on the Community budget ever since Margaret Thatcher demanded her money back in 1979. The main cleavage in these debates is between states (net-payers and net-recipients), not between social classes, the main reference points are inter-nation equity and national ability to pay rather than inter-person distributive justice and individual ability to pay.

To be sure, the trend towards intergovernmentalism in Community funding is often perceived as pathological. In the eyes of the Commission, it fosters 'a narrow "*juste retour*" stance' of the member states and deflects attention from general merits of EU policies for Europe as a whole. A direct fiscal link between European and citizen level should be (re-)established in order to reduce this bias and vindicate the EU as 'a Union of Member States and citizens' (European Commission 2004: technical annex p. 41, 58). Also,

statesmen continue to air the idea of a genuine European tax, showing just how visionary they are about the EU (e.g. Strauss-Kahn 2004; Schüssel 2006). However, the visionary potential of the idea testifies to its lack of political plausibility. Giving taxing powers to the EU would bestow on it a degree of 'stateness' that is unacceptable to most of its citizens and governments. As the EU grows more heterogeneous with each round of enlargement, and as a limit to future enlargement is not in sight, the cohesion of the Union comes to increasingly depend on its not being a state. This all but rules out genuine European taxes and makes the creation of a direct fiscal link to individual citizens exceedingly difficult.

3.2 Internal Security

The debate whether the EU should have its own taxes was motivated by the necessity of financing the EU. The broader political agenda of the EU was concerned with the management of the consequences of economic interdependence. States created the EU as a response to pressures from domestic economic agents (Frieden 1989; Milward 1984; Moravcsik 1998; Rogowski 1989). Effects of economic interdependence and potential gains from cooperation was real in the economic realm and was perceived by the relevant actors. This also applied to the failed attempts to create a European Defence Community in the early 1950s. In the emerging Cold War constellation, it made sense to cooperate in the field of defense and accept the losses of sovereignty entailed by that cooperation faced with a threatening adversary.

While clear motives and necessities existed in the fields of taxation, market creation and external security, they were absent in the field of internal security. Only convinced European federalists who wanted to create the United States of Europe thought of giving the EU a grip on internal security as the monopoly of force belonged to the attributes of a state. But this view remained marginal. Virtually all other political actors did not consider the creation of a European monopoly of force. For them, internal security was clearly a national issue which was not subject to problems of international interdependence and could therefore be dealt with at the national level. A look into the literature indeed reveals the striking difference between accounts of national economic or external security policy-making on the one hand and accounts of internal security on the other. In the case of the former international issues and interdependence started playing a substantive role already in the 19th century whereas it is almost absent in accounts of the

development of police systems. Histories or comparative studies of the development of national systems of policing and of internal security read like accounts of pathdependent developments shaped exclusively by domestic concerns. As a result, national systems of internal security vary enormously because there was no unifying external force that influenced them (Bayley 1985; Knöbl 1998; Emsley 1996). The only sectors where interdependence existed to some degree were the fields of terrorism and of illicit drugs (Busch 1999; Gal-Or 1985; McAllister 2000). As both were located at a global rather than a regional scale, they were mainly dealt with by the United Nations (and to a lesser degree by the Council of Europe). Overall, however, international institutions in the field of internal security remained weak (Anderson 1989). And as practically no incentive for cooperation existed, cooperation in Europe remained highly informal or ad hoc at best and thus far away from a European monopoly of force.

In the 1970s, interdependencies slightly increased. Member states started to perceive the need for information exchange in the field of terrorism. Their main focus of activity with respect to both terrorism and drugs remained the United Nations (and to some degree the Council of Europe). Only in 1975 the heads of state and of government at their Rome meeting founded the TREVI framework as a reaction to domestic terrorism in a number of member states and its suspected international linkages. This framework was an informal intergovernmental structure and served mainly as a forum for information exchange on terrorism on the level of police officers. It was accompanied by a working group on judicial cooperation which was situated in the framework of European Political Cooperation (EPC, the foreign policy branch). During the 1970s, the main forum of activity was not the EU but the Council of Europe in the field of terrorism and the UN drugs regime with respect to trade and consumption of illicit drugs. The result of the TREVI and judicial cooperation efforts was mostly the development of a differentiated organizational structure used to dealing with police issues and a sense for the important and potentially touchy issues (Busch 1995: 306-19). Only a few decisions had been taken, and they were not binding (Müller 2003: 252-4). In order to deal with the consequences of international interdependence in the field of internal security, member states resorted to traditional concepts of international cooperation. No monopoly of force was needed or asked for.

The '1992' initiative which led not only to the completion of the internal market but also to the abolition of border controls among the Schengen

group substantially increased the interdependence between the member states. 9/11 and the Madrid and London bombings strongly reinforced the perceived problem pressure. However, the continued to be dealt with by intensified international cooperation. A European monopoly of force or even a sharing of the monopoly of force between the EU and its member states are as far away as in the 1970s.

4. The Growth of European Decision-Making Authority Over the Use of Force and Taxation

While the EU is not a state, its basic purpose is to create conditions similar in terms of unity and indivisibility to those within a state. This purpose is enshrined in concepts such as the 'Internal Market' or the 'Area of Freedom, Security and Justice', and requires, first and foremost, the abolition of barriers to cross-border movements within the Union. The abolition of such barriers has major repercussions for national systems of taxation and internal security, firstly, because national tax laws and internal security regulations are potential barriers to movement in their own right, and, secondly, because cross-national differences in taxation and internal security can distort the direction and volume of cross-border flows. As we demonstrate in this section, these repercussions have resulted in considerable de jure and de facto constraints on national decision making autonomy. While the member states retain their monopoly of tax and force, they are no longer free to decide on how to put it to work. Decision making authority increasingly drifts to European institutions in taxation (section 4.1) and internal security (section 4.2).

4.1 Taxation

The EU has no independent power to tax. However, it has the power to regulate the taxing powers of the member states. This power derives from, and is limited to, the purpose of completing the Internal Market. The Internal Market is defined as an 'area without internal frontiers in which the free movement of goods, persons, services and capital is ensured' (TEC Art. 14). Since goods, persons, services, and capital also constitute the major tax bases of the member states – in fact, there is little else worth taxing – the EU's competence for completing the Internal Market implies a residual right

to interfere with national tax policy wherever it conflicts with this goal, i.e. where national tax laws hinder or distort cross-border flows of goods, services and factors of production.

Since it implicates the very core of national sovereignty, the member states have tried to keep the EU competence over taxation as limited, and its exercise as dependent on national approval as much as possible. This is illustrated most clearly by the resilience of the unanimity rule in tax matters (see Article 93 for indirect and article 94 for direct taxation). Ever since the Single European Act, the Commission has called for an extension of qualified majority voting to issues of tax harmonization in order to facilitate decision making (see most recently European Commission 2003) but invariably met with staunch opposition from sovereignty-minded member states (just see Parts 2003; Straw 2003; Department of Foreign Affairs 2005).

The resilience of the unanimity rule is often criticized. The Commission complains about a 'growing gap between decisions needed in the tax field to achieve the goals of the Community ... and the actual results' (European Commission 2001: 3-4), and is seconded by policy experts who view the unanimity rule as the single most important obstacle to the completion of the Internal Market (e.g. Vanistendael 2002).

What is less often noted is that, common complaints notwithstanding, the unanimity rule has not prevented a considerable drift of decision making authority in tax matters to the EU level. This drift started first, and is most dramatic, in indirect taxation¹, where roughly 120 Council directives (Uhl 2007: 60) prescribe *en detail* the systems, base definitions, (minimum) tax rates, and administrative routines to be used by the member states in charging general (VAT) and specific (excises) taxes on consumption. In the field of direct taxation, the same development started later but is also substantial. A small number of directives regulate the taxation of multinational companies in the member states. Additional restrictions are imposed by the European Court of Justice's restrictive reading of the implications of the four basic freedoms of the Treaty for corporate and personal income taxes. Finally, the Commission's competition policy under the state aid provisions also adds to these constraints.

All major taxes are now subject to EU law. EU regulations pre-form and sometimes even pre-empt national tax policy choices even in areas not directly covered by them. The European VAT and excises law, for example,

¹ Indirect taxation includes, most importantly, taxes on general consumption (VAT) and specific goods (excises).

restricts the freedom of national governments to experiment with new taxes or new forms of tax collection (Uhl 2007). The Estonian government is forced to give up its experiment of replacing the conventional corporate tax with a new tax on corporate distributions because the new tax, allegedly, violates EU rules on the taxation of multinational companies (Devereux and Sørensen 2006: 45-47). The strict enforcement of the four freedoms in corporate taxation fuels tax competition and thus constrains national autonomy in tax rate choice (Ganghof and Genschel 2007). In short, while taxes continue to be raised only at the national level, their composition and design is increasingly decided at the European level.

Why did the unanimity rule not prevent the drift of decision making authority to the EU? Four mutually reinforcing mechanisms help to account for this outcome: executive self-interest (Moravcsik 1997), rhetorical entrapment; Schimmelfennig 2003), the joint-decision trap (Scharpf 1988, 2006), and Court activism (Alter 2001). Executive self-interest explains why member state governments have often preferred tax harmonization to non-harmonization despite its constraining effect on national decision making autonomy. Rhetorical entrapment elucidates why the Commission was, at times, able to talk member state governments into unwanted tax harmonization. The joint decision trap explains how member states become locked-in to tax harmonization measures once adopted. Court activism explains how the constraining effect of established harmonization directives and, more importantly, EU treaty law on national tax policy making can increase considerably even in the absence of political consent of member state governments.

Executive self interest: It is a central tenet of rational choice theory that self-imposed constraints can be empowering (Elster 1979). Applying this tenet to intergovernmental bargaining, some analysts have argued that member state governments often agree to new constraining EU law in order to strengthen their position in domestic politics (Grande 1996; Moravcsik 1997; Wolf 2000). This argument may also apply to tax harmonization. Case study evidence suggests that the member state governments pursued the harmonization of indirect taxation not only as a means to the European end of completing the Internal Market, but also a means to reforming their national tax systems. Take VAT as an example. Since the 1960s, it was widely agreed among public economists and tax policy makers that a broad based VAT is the optimal form of taxing general consumption (Cnossen 1998). Acting on this consensus was made difficult by domestic political resistance.

Small businesses opposed the introduction of VAT because they feared more administrative red tape and an increased tax burden. Interest groups lobbied for favourable tax treatment of various goods and services, thus posing a constant threat to maintaining a broad based VAT. By agreeing on a common VAT system in 1967 and the main ingredients of a common VAT base in 1977, governments made it easier for themselves to keep this domestic opposition at bay (Puchala 1984; Genschel 2002). A similar argument can be made for the harmonization of excises. It also facilitated a reform trend towards simpler and administratively less burdensome taxes on specific goods that member state governments pursued for purely domestic reasons. This is not to say, however, that all agreed harmonization measures are always perfectly in line with the domestic policy preferences of the member states.

Rhetorical entrapment: Member state governments are often torn between a general commitment to advancing European integration and specific policy preferences that conflict with this goal. They endorse, for example, the Internal Market as a matter of principle but oppose concrete steps towards market integration on the grounds of material interest. By exposing the inconsistency between words and deeds, the Commission – or other actors with a material stake in increased integration – can sometimes manage to shame governments into agreement on specific integration acts they would have preferred to avoid (see also Elster 1989; Schimmelfennig 2001). This mechanism also operates in tax harmonization as exemplified by the introduction of the so-called transitional system of VAT in 1991 (Genschel 2002). Since the 1960s, the Commission had called for the elimination of special tax formalities on cross-border trade in the name of unrestricted economic exchange among the member states. However, the member states were reluctant to heed this call because they relied on these formalities as a means of keeping a check on the national VAT base.

When in March 1985, the European Council asked for a program for the completion internal market, the Commission seized this opportunity to coax the member states into revising this position: Without elimination of tax controls on cross-border trade, it told them in its now famous White Paper, the Internal Market would remain fundamentally incomplete (European Commission 1985). Eager to vindicate their commitment to ‘1992’, the member states grudgingly agreed to reform the tax treatment of cross-border trade. While they still refused to abandon special controls altogether, as demanded by the Commission, they decided to move them from customs posts

at the border to tax offices behind the border. This allowed for the abolition of tax-related frontier controls, and, hence, an Internal Market without 'physical barriers' but at the price of decreasing the effectiveness of controls. By agreeing on the transitional system, the member states thus inadvertently contributed to the increase in VAT-fraud that they now often complain about and that the Commission cites as proof of the need for further VAT integration. The drive for a common consolidated corporate tax base provides a more recent example of the Commission trying to exploit the member states' rhetorical commitment to market integration to cajole unwilling governments into tax harmonization measures they would wish to avoid.

Joint decision trap: The unanimity rule makes it difficult not only to adopt harmonization measures but also to revise them once adopted. Since any revision requires consensus again, change is difficult. And the difficulty increases as each consecutive round of enlargement increases the number of member states. As a consequence, member state governments may be locked in to EU tax laws they no longer consider appropriate – if they ever did so. In 2006, the governments of Austria and Germany contemplated a national switch to the so-called *reverse charge* system of collecting VAT in order to combat VAT fraud. Since this system deviates from the harmonized principles laid down in the sixth VAT directive, they asked the Commission for derogations.² The Commission refused to grant these derogations 'insofar as they would make life more complicated, rather than simpler both for taxable persons and tax administrations in addition to providing more, rather than less scope for tax evasion' (European Commission 2006: 6). Whatever the merit of this judgement, it is interesting to note that it is the European Commission which decides on the efficiency and effectiveness of proposed national tax reforms, not the national governments concerned. The only way for Germany and Austria to overrule the Commission's decision is by convincing their 25 fellow governments to agree to a harmonized switch to the reverse charge system, which, of course, is exceedingly difficult. They are thus locked-in to the current system of collecting VAT even though they consider it inappropriate for their specific needs.

Court activism: Precisely because the unanimity rule makes it difficult for the Council to make and amend EU tax law, it gives considerable leeway to the European Court of Justice to create judge-made tax law (Alter 1998;

² The derogation would have needed the unanimous consent of the Council to become effective.

Scharpf 2006). By reading harmonization directives differently, and more narrowly than originally intended by the member states, it can increase the specificity and constraining effect of EU law. For example, when the Council failed to achieve the complete harmonization of the VAT base intended by the Commission with its sixth VAT directive in 1977, the Commission brought 'a hundred bloody VAT infraction cases for not dotting this I or not crossing this t' (Hahn 1988:230) to increase the restrictiveness of this directive beyond what the member states had originally agreed to in the Council. More importantly, by reading tax policy implications into general provisions of the Treaty, the ECJ can create European tax law in areas where the member states never agreed to have any such law in the first place. This is especially important in corporate and personal income taxation, where the number of harmonization directives is very limited. Here the Court has, in recent years, struck down a great number of national tax provision as violating the four freedom guarantees of the Treaty. In this way, it has established robust European rules for non-discrimination of cross-border income streams. These rules not only forced member states to adjust their tax systems and tax base definitions, for example, by abandoning purportedly discriminatory imputation systems of corporate taxation or by allowing for cross-border loss-offset between related companies (Graetz and Warren 2006). In so doing, they also made it easier for taxpayers to shift profits to low-tax and deductible expenses to high-tax member states in order to reduce their overall tax bill, and, thus, contribute to fuelling European corporate tax competition. This competition has significant push-on effects on personal income taxation, and, arguably, is one of the main drivers behind the pervasive trend towards replacing comprehensive and progressive income taxes by either dual income taxes or flat taxes (Ganghof and Genschel 2007). There is no reason to suppose that the member states would have unanimously agreed to any of these judge-made rules, had they had the chance to vote on them in the Council of Ministers. When, for example, the Commission proposed a directive to liberalize foreign loss offset in the early 1990s, it was blocked by the Council (Genschel 2002:213).

The four mechanisms – executive self-interest, rhetorical entrapment, joint decision trap, and Court activism – do not operate in separation but feed on each other. The activism of the ECJ can change the default condition of intergovernmental negotiations in the Council of Ministers and thus shape the definition of executive self-interest. While governments may not find tax harmonization in their interest in the absence of Court rulings, they

may well do so in the presence of court rulings. In fact, one major selling point of the Commission's project of a common consolidated corporate tax base is to protect the member states from an uncontrolled, and piecemeal elimination of discriminatory tax barriers between national corporate tax systems by ECJ litigation (European Commission 2003). The Courts restrictive interpretation of the four freedoms although vindicates the Commission expansive reading of the tax policy implications of the Internal Market and, thereby, reinforces the effectiveness of rhetorical entrapment. The joint decision trap provides the ECJ with material to work on, and in turn, prevents the Court from being overruled by the Council.

As a consequence of these intersecting and mutually reinforcing processes the national power to tax is now embedded in and disciplined by a dense network of European rules and regulations. The member states are still the only political units with a right to levy tax but which tax they levy and how they levy it is increasingly decided at the European level. Tax levels continue to vary widely, but tax systems, bases and rate structures come to look increasingly alike.

4.2 Internal Security

After the slow beginnings in the 1970s, the Europeanization of decision-making authority in the field of internal security took off in the early 1990s. The causes of this development are the spill-over from the internal market program, later intensified by an increased rhetorical commitment of member states to the maintenance of internal security in the aftermath of 9/11, and court activism.

Spill-over: The first and most decisive cause for the development of much more extended and intrusive rules came from the initiative to complete the internal market by 1992. This initiative was conceived of as a largely economic project for more competitiveness, growth and jobs. In order to ease transactions between the member states, internal borders should be abolished. What sounded like the necessary requirement of market creation and the fulfilment of Euro-enthusiasts' dreams amounted to a political revolution the consequences of which are still not completely visible: With the abolition of borders, the state loses a key instrument of control over what happens inside its borders. While the abolition of internal borders was the most important single measure of 'negative integration' in the EU, its per-

ceived consequences lead to what neofunctionalists used to call ‘spill-over’ from market regulation to internal security issues.

As a result, cooperation moved from informal exchange among police experts to formal law-making activity and dramatically increased in scope and intensity. Whereas internal security (or justice and home affairs) was not a formal EU competence in the mid-1980s when the internal market initiative was designed, the Maastricht Treaty of 1991 already formalized and consolidated the existing forms of cooperation into what became known as the ‘third pillar’ of the EU. The sensitivity of the issues dealt with in this pillar are illustrated by the fact that decision-making in the Third Pillar was fundamentally different from the classical Community method in that the European Commission did not possess the monopoly of initiative, the European Parliament did not co-legislate and the European Court of Justice was not allowed to adjudicate. This setup was substantially changed only six years later in the Amsterdam Treaty where some parts of the Third Pillar (asylum and migration) were moved into the Community area and the scope of the issue area was extended.

In the late 1980s and early 1990s, the member states had concluded a substantial number of international conventions in order to move forward in the field of internal security without having a sufficient legal basis in European law. The most important examples of a larger set are the Schengen Implementation Agreement of 1990, the Europol Convention of 1995 and the Prüm Treaty of 2005. While the Amsterdam Treaty substantially simplified the adoption of these conventions which now if ratified by half of the member states enter into force for those states it also introduced the instrument of ‘framework decisions’ in order to further ease decision-making. Framework decisions are similar to directives in the Community legal framework and are now being increasingly used.

Finally, the EU member states adopted a number of action plans and programmes from the ‘Palma document’ of 1989 to the Hague program of 2005 with a substantial number of programs in between. Although these programs were not legally binding, they are an indicator of the importance of the matter for member states and constitute a measure against which their actions could be assessed.

After the spill-over pressure from the abolition of internal borders in the context of the internal market program, the second strong impulse in the field of justice and home affairs came from 9/11. Whereas the abolition of internal borders had mainly led to the establishment of the policy field at the

EU level, 9/11 increased its importance and even further intensified its pace. Most notably, 9/11 eased the adoption of the European Arrest Warrant, a major change in EU police cooperation (see below).

Although justice and home affairs started much later than taxation as a substantial activity of the EU, its development in less than 20 years has been dramatic. Both the scope (in terms of the range of issues covered) and the depth (in terms of the compulsory nature of the measures adopted) have strongly increased. In terms of depth, justice and home affairs has moved from informal cooperation over international law conventions outside of the EU framework to binding intergovernmental decisions similar to the ones to be found in the Community area of the EU and partly to a communitarization. In terms of scope, the initial focus on serious crime and terrorism has been substantially extended and now covers asylum, migration, terrorism and organized crime of a much broader range, criminal law including criminal law aspects of Community policies and the protection of external borders. The dramatic increase in activity and the potential impact on the state's ability to use its monopoly of force without external interference is nicely captured by a study which looked at the degree to which legislation of the German *Bundestag* in specific issue areas was influenced by EU inputs.

Table 1: *Bundestag* Legislation in an Issue Area Influenced by European Impulses (in percent)

<i>Subject Area</i>	<i>10th ET</i> (1983-87)	<i>11th ET</i> (1987-90)	<i>12th ET</i> (1990-94)	<i>13th ET</i> (1994-98)	<i>14th ET</i> (1998-2002)	<i>15th ET</i> (2002-2005)
Home Affairs	4.4	2.3	14.5	11.9	19.2	12.9
Justice	9.8	35	20	21.6	34.1	42.2
...
Average	16.8	19.9	24.1	25.9	34.5	34.6

Source: Töller 2006: 7; ET = electoral term

The table nicely captures the increasing degree to which legislative activity in justice and home affairs was influenced by the EU as well as the dramatic increase after the decision on the internal market program in 1985 and the boost after 9/11.

Apart from this increase in the scope and depth of activity which gives a rough overview of the changes in the policy field over the years, major

qualitative changes have also occurred in important substantive issues. Member states have pooled their competencies in key areas, and there is even a certain degree of delegation in some instances. These changes will be subsequently discussed.

One of the most important developments is the transformation of the traditional extradition regime towards the European Arrest Warrant. This is a key issue for the exercise of the state monopoly of force because it regulates the way persons who have been arrested are transferred to another country. As arresting people is a fundamental intrusion into personal liberty, it is something that only the state is authorized to do under certain precisely circumscribed procedures. As it is the manifestation of the state's monopoly of force, external interference is not desired. Therefore, the transfer of arrested people from one state to another has been subject to mostly bilateral treaties of extradition. The dominance of a bilateral approach already shows that states wanted to keep the issue under firm control and deal with it on a case-by-case basis. Two important features of this extradition practice are important here: states usually do not extradite persons 'automatically' if certain predefined conditions are met but reserve the right for a political decision on the concrete case, and states reserve the right to exclude certain categories of offenses (usually 'political' ones such as terrorism). Several countries refuse to extradite their own citizens. This reflects the view that states are sovereign in deciding whom they arrest and do not allow external interference (Bassiouni 2002).

This model preserved sovereignty and autonomy in the exercise of the monopoly of force. However, the price to be paid was efficiency: sovereignty concerns made it more difficult for states to get hold of serious offenders. As a consequence, the Council of Europe had tried to establish a multilateral convention on extradition in the hope that this might ease prosecution and extraditions among its democratic members. However, the European Convention on Extradition of 1957 has numerous declarations annexed to it specifying exceptions. The United Kingdom even refused to sign the convention altogether. After the new legal basis provided by the Maastricht Treaty, the EU member states adopted a convention on a simplified extradition procedure among themselves (EU Council 1995). But the key problem remained: arresting, punishing and extraditing individuals is the most visible sign of the state monopoly of force and subject to highly different national systems of norms and regulations which had developed independently of each other and taken very different forms.

The European Arrest Warrant (EAW) was adopted in 2002 (EU Council 2002). Preparations had been under way for some time but 9/11 clearly eased the final decision. The EAW is a fundamental break with the past. First, its coverage is very broad and includes terrorism as well as rape or arson (32 offenses altogether). Second, the principle of double criminality does not apply. In other words, a person can be arrested on the basis of an EAW even if the crime does not exist in the jurisdiction of the state where the person is currently located. Third, there is no political decision whether to extradite or not but only a legal-procedural check. Fourth, states are required to arrest their own citizens and transfer them to the requesting state. The whole procedure should not last longer than three months.

The EAW is explicitly based on the principle of mutual recognition. When this principle was formulated by the ECJ's famous *Cassis de Dijon* decision in 1979 it was also considered as a revolution. But product safety standards, as important as they are, are different from criminal procedures and penal law. The general acceptance of the principle of mutual recognition is not restricted to the European Arrest Warrant but offers the basis for a further horizontal delegation of sovereignty in the field of criminal justice, e.g. in the case of the still pending decision on the European Evidence Warrant.

The European Arrest Warrant was used here to illustrate with a qualitative example the quantitative evidence given above on the increase in scope and depth of EU activities in justice and home affairs. Although it will certainly lead to a relative small share in the total number of arrests, and although there are still loopholes and reservations, its significance should not be underestimated. It is a clear limitation of state sovereignty in the field of the use of the monopoly of force: States are not free to decide whom to arrest on their territory and what to do with these people. The principle adopted is an innovative one and might indicate the general way EU member states are dealing with the monopoly of force. It does not generate a supranational monopoly of force or a supranational police authority (a European 'FBI'). It also does not allow the police forces of one state to make arrests on the territory of another state. Instead, it makes the police forces of one state act on behalf of another state and without much room for individual discretion. It is thus a case of horizontal delegation – not to an independent supranational entity (as e.g. in the field of monetary policy and the European Central Bank) but in a generalized form to other EU member states. The EU member states have given up a decade-long practice and have

pooled their sovereignty for the definition of criteria of a small but important area where they delegate the use of their monopoly of force to each other.

Court activism: Initially, the member states had taken great care to avoid delegation of adjudication powers in justice and home affairs to the European Court of Justice. During the informal cooperation before the Maastricht Treaty, it did not have any powers. In the Maastricht Treaty, the ECJ was only allowed to decide about convention adopted under Art. K.3 (2) (c) and Art. L, and only if the member states had agreed to this role. However, Art. M also stipulated that the provisions of the Treaty on European Union should not affect the EC Treaties. This opened up an entry point for the ECJ to deal with criminal law aspects of Community Policies. Later, it was decided that the ECJ was also competent 'to give preliminary rulings on the validity and interpretation of framework decisions and decisions, on the interpretation of conventions established under this title and on the validity and interpretation of the measures implementing them' (Art. 35 (1) TEU). Again, member states have to acknowledge the right of the ECJ to become active in a preliminary ruling procedure.

Still, we see the general pattern of development in justice and home affairs: The ECJ becomes increasingly involved. Whereas it could only adjudicate on conventions in the Maastricht Treaty, its scope of activity is now expanded. Both avenues for ECJ involvement, the link between the Community and the Third Pillar, and the possibility of preliminary rulings, led to a number of ECJ rulings. Two of them are of particular importance. In case C-176/03 (Commission vs. Council), the ECJ decided on the criminal justice competence of the Commission and annulled the Framework Decision on the criminal justice protection of the environment. In case C-105/03 (Pupino), the ECJ ruled that framework decision 2001/22/JI on the protection of victims had direct effect – despite the wording of Art. 34 (2) (b) of the TEU which stipulates that framework directives 'shall not entail direct effect'.

Although the latter ruling in particular is highly controversial, it is clear that the ECJ is taking an increasingly active stance in justice and home affairs and seems willing to shape this area with the same decisiveness it has shaped Community policies – with the difference that this time, it is much closer to the state monopoly of force.

5. Multi-level but not Federal: Taxation and Internal Security in the EU

European integration affects taxation and internal security in two, partly contradictory, ways. On the one hand, it leaves the member states' monopoly of force and taxation intact and may even strengthen it. On the other hand, it causes an incremental drift of decision making power from national governments to European institutions. Taxation and policing remain entirely national in the sense of being performed exclusively by national authorities and solely on the basis of national law. They are Europeanized in the sense that the conduct of national authorities is increasingly subject to European supervision and the content of national law is increasingly moulded or even pre-empted by European law. In this section we review the causes behind these opposite trends, and consider the shape of the multi-level structure created by them.

The major reason why European integration has left the national monopoly of force and taxation unscarred is enlargement. As the EU grows larger and more heterogeneous the appeal of the federal vision fades. The Dutch and French referenda on the Constitutional Treaty have shown dramatically that the old neo-functionalist idea of the EU eventually replacing the member states as the centre of political authority carries little favour with voters. To the contrary, the legitimacy of the Union now seems to hinge on not visibly threatening the continued political pre-eminence of the member states. This makes it impossible to bestow European institutions with the most important and visible insignia of national statehood, namely the power to tax and use force. Since the British entry in 1973 at the latest, the chances of a genuine European tax let alone a European army or police force seem close to zero.

While resistance to the idea of a European super-state is pronounced and widespread, there is hardly any resistance to the EU's animating purposes being defined as creating, at the European level, conditions similar to those within a nation state. The concepts of the Internal Market and the Area of Security, Freedom and Justice are emblematic of this purpose. Since the EU cannot achieve this purpose by introducing unifying European level taxes or police forces, precisely because this would signal a conversion to European statehood, it has to rely on coordination and harmonization. Measured against the ideal standard of a completely borderless Internal Market or Area of Security, Freedom and Justice, this coordination and harmonization can-

not but remain deficient. However, measured against the ideal standard of untrammelled state sovereignty in taxation and internal security, the insufficient state of coordination and harmonization already implies a considerable loss of national decision making control.

The EU is torn between the impulse to create conditions similar to those within a state and the impulse not to become a state itself. This tension shapes the emergent European multi-level system of taxation and policing. This system is decidedly not federal because the EU level lacks what the federal level in federal states invariably has: independent tax and police power. While in the EU all taxing and police power is vested in the member states – there are no European taxes or police forces – most of the taxing and police power in federal states is vested in the federal government. In the United States for example, federal taxes raise more than two-thirds of all tax revenue, and there is a strong federal police force. However, the European system is multi-level in the sense that decisions as to what to tax on what base and at what rate, or how to put national police forces to work are increasingly pooled in or even delegated to European institutions. The monopoly of force and taxation remains national but is embedded in an increasingly dense network of European rules and regulations.

In a sense, the assignment of government functions in the multi-level system of the EU is the reverse of that of a federal multi-level system such as the United States. In the United States, the concentration of taxing and police powers in the federal government allows for a high degree of decentralization of decision making: Because federal taxes dwarf sub-national taxes in importance, less federal involvement in sub-national taxation is needed in order to preserve a sufficient integration of the national market. The decentralization of tax and police powers in the EU, by contrast, requires a much higher degree of centralized decision making in order to prevent a fiscal fragmentation of or physical barriers in the Internal Market: because all taxation and policing is performed by the member states, differences and interface problems among the member states are much more important than differences and interface problems among the states of the United States.

The emergence of the European multi-level system of force and taxation leads to a Europeanization of the nation state in the EU. The continued existence of the nation state is not threatened because the legitimacy of the EU is premised on preserving it. This means, first and foremost, preserving the national monopoly of force and taxation. However, the state is broken up as

a self-contained system of taxation and policing because many important policy decisions are now preformed at the European level.

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